

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

NOTICE BY ELAM UTILITY COMPANY,)
INC., TO INCREASE ITS RATES) CASE NO. 8929
FOR GAS SERVICE)

O R D E R

On November 1, 1983, Elam Utility Company, Inc., ("Elam") filed its notice with the Commission requesting a general increase in rates of \$29,311 and an interim rate increase of \$13,300 pursuant to KRS 278.190(2). In a revised filing in which many corrections were made to its billing analysis, Elam revised its general and interim requests to \$34,108 and \$15,535, respectively. The requested interim increase of \$15,535 was granted by the Commission in its Interim Order of January 20, 1984. Elam stated that the requested general increase was required due to decreasing sales levels which have caused decreased earnings.

On November 16, 1983, the Consumer Protection Division in the Office of the Attorney General moved to intervene in this proceeding pursuant to KRS 367.150(8), which motion was granted. No other parties appeared to formally intervene. The Commission scheduled a hearing on the matter and directed Elam to give notice to its consumers of the proposed rates and the hearing scheduled for March 1, 1984.

This Order addresses the Commission's findings and determinations on issues presented and disclosed in the hearing and investigation of Elam's revenue requirements and rate design. The rates granted herein increase Elam's annual revenues by \$30,691 or 8.5 percent.

COMMENTARY

Elam is a privately-owned gas distribution utility providing natural gas service in Morgan County, Kentucky, to approximately 410 customers. Elam purchases its gas from Columbia Gas Transmission Company and Capitol Oil and Gas Company.

TEST PERIOD

Elam proposed and the Commission has accepted the 12-month period ending July 31, 1983, as the test period for determining the reasonableness of the proposed rates. In utilizing the historic test period, the Commission has given full consideration to appropriate known and measurable changes.

VALUATION

Net Investment

Elam proposed a net investment rate base of \$454,155. The Commission concurs with this determination with the following exceptions:

The Commission has increased plant in service by \$960 to reflect the capitalization of outside labor costs which were improperly charged to expense during the test year.

The allowance for working capital has been increased by \$545 to reflect the pro forma adjustments to operating expenses

allowed herein. The Commission has further adjusted the proposed rate base to reflect the allowed pro forma adjustment to depreciation expense in the calculation of the depreciation reserve.

Based on the Commission's adjustments, Elam's net investment rate base for rate-making purposes is as follows:

Utility Plant in Service	\$522,088
Add:	
Materials & Supplies	\$ 6,490
Working Capital	10,678
Subtotal	<u>\$ 17,168</u>
Deduct:	
Accumulated Depreciation	\$ 86,817
Net Investment	<u><u>\$452,439</u></u>

Capital Structure

The Commission finds from the evidence of record that Elam's capital structure for rate-making purposes is \$448,881 and consists of \$639,990 in long-term debt and a negative equity balance of \$191,109. This equity balance reflects adjustments to the test year for operating and depreciation expenses based on the capitalization of outside labor costs addressed in the preceding section.

REVENUES AND EXPENSES

Elam proposed several adjustments to revenues and expenses to reflect more current and anticipated operating conditions. The Commission finds the proposed adjustments are generally proper and acceptable for rate-making purposes with the following exceptions:

Labor Costs

During the test year Elam reported \$960 in operating expense for outside labor costs incurred in connection with the installation of new distribution lines. The Commission is of the opinion and finds that these costs should properly have been capitalized rather than expensed and, therefore, has made an adjustment to reduce Elam's test-year operating expenses by \$960.

Depreciation Expense

Elam proposed an adjustment of \$3,189 to increase its annual depreciation based on the year-end level of plant in service. The Commission has increased this amount to reflect the annual depreciation of the addition to plant of \$960 for labor costs that were improperly charged to expense during the test year. Based on the 30-year depreciable life utilized by Elam for depreciating distribution lines, this results in an increase to the depreciation expense adjustment of \$32 resulting in an overall adjustment of \$3,221.

Donations

During the test year Elam incurred \$60 in expenses for donations to various civic and charitable organizations. The Commission is of the opinion that expenditures of this type produce little, if any, benefit to Elam's consumers and, therefore, should not be allowed for rate-making purposes.

Advertising

During the test year Elam incurred operating expenses in the amount of \$126 for institutional and promotional advertising. In accordance with the provisions of 807 KAR 5:016, the Commission

has reduced operating expenses to eliminate this cost for rate-making purposes.

Christmas Bonuses

Elam incurred \$451 in expense during the test year for Christmas bonuses and a Christmas dinner for its employees. Elam presented no evidence in support of the reasonableness of these expenses nor did it show that these expenditures were needed because its employees are not adequately compensated otherwise. The Commission is of the opinion that expenses of this type, while obviously promoting employer-employee relations, are not necessary for the operation of the utility and, therefore, should not be borne by Elam's ratepayers. Accordingly, the Commission has made an adjustment to reduce operating expenses by \$451 for rate-making purposes.

Accident-Related Expense

During the test year Elam incurred operating expenses of \$75 to pay for damage to an automobile caused by an accident involving Elam's service truck. The Commission is of the opinion that such an expense is unusual and non-recurring in nature and should not be included herein for rate-making purposes. Therefore, an adjustment has been made to reduce Elam's test-period operating expenses by \$75 for rate-making purposes.

Rate Case Expense

Elam proposed an adjustment of \$1,333 to amortize its projected rate case expense of \$4,000 over a period of 3 years. The itemized invoices filed to support the expense incurred for legal and accounting services provided for this case show that

\$530 related solely to Elam's filing for interim rate relief. The failure of Elam to perceive its worsening financial condition and file for rate relief in a timely manner rests not with Elam's ratepayers but with its management. Therefore, the Commission is of the opinion that any cost incurred as a result of the request for an interim rate increase should not be borne by the ratepayers and, therefore, based on the 3-year amortization period, Elam's proposed adjustment has been reduced by \$177.

The effect of the accepted pro forma adjustments on Elam's net income is as follows:

	<u>Actual Test Year</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Year</u>
Operating Revenues	\$362,179	\$ <2,885>	\$359,294
Operating Expenses	<u>344,780</u>	<u><2,313></u>	<u>342,467</u>
Operating Income	\$ 17,399	\$ <572>	\$ 16,827
Interest on Long- Term Debt	56,581	<23,883>	32,698
Other Income and (Deductions) - Net	<u>1,123</u>	<u>-0-</u>	<u>1,123</u>
Net Income	<u>\$<38,059></u>	<u>\$ 23,311</u>	<u>\$<14,748></u>

REVENUE REQUIREMENTS

Elam based its requested increase on a return of 10.1 percent on its net investment rate base which was the return granted in its last general rate case. The actual return on Elam's requested rate base for the test year was 3.85 percent. After taking into consideration the accepted pro forma adjustments, Elam's adjusted rate of return is 3.72 percent. The Commission is of the opinion that the adjusted rate of return is inadequate and a more reasonable rate of return would be 9.85

percent. This rate of return, which reflects the Commission's move toward slightly lower returns in recent months based on changing economic conditions, results in an additional revenue requirement of \$30,691.¹ This additional revenue, after the provision for income taxes of \$2,953, will provide net income of \$12,990, which should be sufficient to allow Elam to pay its operating expenses, meet its mortgage requirements and maintain an adequate surplus for equity growth.

WHOLESALE SUPPLY OF NATURAL GAS

Mr. B. C. Phillips, Elam's president, indicated at the hearing of March 1, 1984, that Elam had been engaged in negotiations for an alternative supply of natural gas from a local producer in Morgan County at a rate of \$2.50 per Mcf. The Commission encourages Elam to actively pursue these negotiations and to try and achieve some flexibility in gas purchases in view of the rates of \$4 and \$5 per Mcf it is presently being charged by its current wholesale suppliers.

With the increase in rates granted herein, Elam's consumers' bills for an average monthly usage of 10 Mcf will be \$85. Bills of this magnitude give Elam one of the three highest

¹ Required Operating Income	\$44,565
Less: Adjusted Operating Income	16,827
Operating Income Deficiency	\$27,738
Less: Adjusted Test Year Loss	14,748
Taxable Operating Income Deficiency	\$12,990
Retention Factor	.8148
Revenue Required for Taxable Deficiency	\$15,943
Revenue Required for Test Year Loss	14,748
Total Additional Revenue Requirement	<u>\$30,691</u>

residential rates among gas distribution companies regulated by this Commission. With the prospects of continually declining sales due to consumers switching to alternative fuel sources, it is imperative that Elam do everything it can to hold its rates at current levels, or reduce them if possible. Otherwise, Elam may eventually reach a point where increasing rates and declining sales levels would make it unable to function as a viable business entity. The Commission will require a status report on the negotiations with a local producer for an alternative gas supply to be filed within 60 days from the date of this Order.

SUMMARY

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The rates in Appendix A are the fair, just and reasonable rates for Elam and will provide net income sufficient to meet the requirements in Elam's mortgage agreement securing its long-term debt.

2. The rates and charges proposed by Elam differ from those found reasonable herein and should be denied upon application of KRS 278.030.

IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved for service rendered on and after the date of this Order.

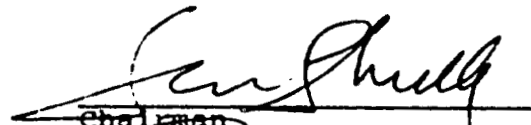
IT IS FURTHER ORDERED that the rates proposed by Elam be and they hereby are denied.

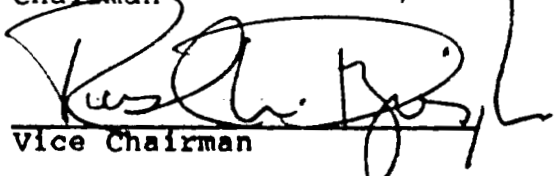
IT IS FURTHER ORDERED that Elam shall file within 60 days from the date of this Order a status report on its negotiations for a less expensive supply of natural gas.


IT IS FURTHER ORDERED that Elam shall file with the Commission within 30 days from the date of this Order its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 2nd day of May, 1984.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Acting Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 8929 DATED 5/2/84

The following language is prescribed for the customers in the area served by Elam Utility Company, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the date of this Order.

Residential & Commercial

Customer charge	\$4.00
First 11 Mcf	\$8.15
Over 11 Mcf	\$9.15

Industrial

Customer charge	\$5.00
All Mcf	\$8.15

The above rates have incorporated the rates established in
PGA Case No. 8929-B.